Fordham Journal of Corporate & Financial Law

Volume 2, *Number* 1 1997 *Article* 2

Institutional Investors: Agents of Change

James E. Heard*

*

INSTITUTIONAL INVESTORS: AGENTS OF CHANGE*

*James E. Heard***

I. INTRODUCTION

Thank you very much. I am glad to be with you tonight, and thank you to Fordham Law School for having me here.

Most of what I am going to talk about tonight is not what is happening this year, but about the recent history of corporate governance.

History was always my favorite subject in high school and in college and, next to ESPN, the History Channel is my favorite channel on television. So I thought what I would do is talk a little bit about the history of the last decade. That is, the history in terms of what has happened in corporate governance, from the angle of the institutional investor or someone who has worked with institutional investors for quite some time.

Earlier today, I was in a meeting down in the Wall Street area with a friend and colleague who does international corporate governance counseling and investor relations. He brought into the meeting a young lady, a senior at one of the local high schools, and explained to me that she was spending her day at his firm as part of a work study project for one of her classes.

So we had our meeting and talked about the business issues which we had to talk about. Then my friend left the room for a few minutes. The young lady turned to me and said, "So what is corporate governance?"

I said, "Well it is like this. We have a business system where people who own the company supposedly choose people called directors, who have oversight responsibility. The directors hire and oversee the

---

* This speech was part of a symposium held at Fordham University School of Law on March 13, 1997 entitled, **Reshaping Corporate Governance & Shareholder Activism for the 21st Century.**

** James E. Heard is founder of Heard & Associates which provides corporate governance advisory services to corporations and institutional inverstors. Prior to the founding of his firm, Mr. Heard served as president of Institutional Shareholder Services, which he built into the leading proxy voting advisory firm in the United States.

managers and executives of the company. If the managers do not do a good job, then the directors replace the managers. Every year, or every couple of years, the directors have to get reelected by the shareholders. That is the theory."

I added, "But the reality is almost the other way around; the directors are chosen by the management and then the shareholders ratify the selection of the directors. That is changing however, and directors are beginning to do the job they are supposed to do."[1] That was the two-minute version of corporate governance.

II. INSTITUTIONAL INVESTOR'S EFFECT ON DIRECTORS

What has happened in the last decade is really what I wanted to talk about tonight. Not to tell you anything that you probably do not know, but just to remind you of what really happened in the last decade.

It is very easy to forget how much has changed. Chief Executive Officers ("CEOs") do not call all the shots anymore, boards are expected to be independent and to do real work.[2] Corporations understand that their primary responsibility is to create wealth for their owners.[3] Today, CEOs, boards, and corporations are being held accountable for their performance.[4]

What has happened and what has caused this to happen? Jon Lukomnik touched, I think, on the

---

[1] Todd Hyten, *Above Board: Directors Get Back to Business*, BOSTON BUS. J., July 28, 1995, at 12 (explaining that the days of "Old Boy" Board of Directors are over and that directors today have a job to do, and are under pressure to perform).

[2] *Id.*

[3] *See* Milton Friedman, *The Social Responsibility of Business to Increase Its Profits*, N.Y. TIMES MAGAZINE, Sept. 13, 1970, at 125 (noting corporation's duty is to maximize profits); *see also* Lex Alexander, *Corporate Dilemma*, NEWS & RECORD, Sept. 1, 1996, at E1 (stating that economist Milton Friedman wrote a short but influential article arguing that a corporate director's highest obligation is to maximize shareholder value and to make the company or its stock worth as much as possible without breaking the law). Such arguments later were extended by others to maintain that corporations are, and should be, amoral, accountable to no particular moral standards. *Id.*

[4] *See* Gerald A. Kraines, *Hierarchy's Bad Rap*, J. BUS. STRATEGY, July/Aug. 1996, at 13 (explaining that shareholders are holding directors more accountable, just as directors are holding managers accountable, and so on down the line); *see also* Jay W. Lorch, *The Board as a Change Agent; Board of Directors*, CORP. BOARD, July 1996, at 1 (stating that Stempel at General Motors Corporation ("GM"), Olson at Digital Equipment Corporation ("Digital" or "Digital Equipment"); Robinson at American Express Company ("AMEX"), Lego at Westinghouse Electric Corporation ("Westinghouse"), and Akers at International Business Machines Corporation ("IBM") are clear examples of CEOs who have been held accountable for poor performance).

basic reason,[5] but let me go over it quickly once again. We have seen the level of institutional ownership increase; institutional ownership of our public corporations has risen from 5 percent fifty years ago to more than 50 percent today.[6] For our largest companies, say the largest 1,000 companies, institutional ownership is 60 or 70 percent in many cases.[7]

This reaggregation of ownership has had a number of consequences. It has caused many institutions to adopt long-term investment strategies, it has caused them to question the wisdom of the "Wall Street rule."[8] Many of the institutional investors, as Jon [Lukomnik] said, now prefer to use voice over exit. This has given institutional investors both opportunity and reason to use their ownership rights to increase value and to improve the system of corporate governance.[9]

The emphasis on increasing shareholder value and a revitalization of our corporate governance system has developed together.[10] You could say that they are the twin *mantras* of active institutional investors.

I should point out that not every institutional investor is an activist. In fact, most of them are not. For

---

[5] *See* Jon Lukomnik, Why We Bother: *A Primer on How Activism Enhances Returns,* 2 FORDHAM FIN. SEC. TAX L.F. 5 (1997).

[6] *See* Chris Mallin, *Voting and Institutional Investors,* ACCT., Sept., 1995, at 76 (noting that U.S. institutional investors, primarily large pension funds and mutual funds, collectively own over fifty percent of U.S. equities and for many large corporations institutional ownership far exceeds fifty percent). Institutional investors account for eighty percent of all shares traded in the U.S. *Id.*; *see also Assets Surge For U.S. Institutional Investors And Public Pension Funds Increase Equity Control Over Corporate America; Companies Facing 'Double Whammy', Says New Conference Board Report,* P.R. NEWSWIRE, Feb. 26, 1997 (discussing that U.S. institutional investors command an estimated forty-seven percent of the total U.S. equity markets (2Q 1996), although they tend to invest more heavily in the largest companies). Institutional Investors have increased their holdings to slightly more than fifty-seven percent of the stock of the largest 1,000 U.S. corporations. *Id.*

[7] *Id.*

[8] Chamu Sundaramurthy, *Governance Antecedents of Board Entrenchment: The Case of Classified Board Provisions,* J. MGMT., Sept. 19, 1996, at 783 (defining the Wall Street Rule as: selling stock if you are unhappy with management).

[9] Lukomnik, *supra* note 5; Richard H. Koppes, *Institutional Investors Demand More Accountability,* NAT'L LAW J., Apr. 14, 1997, at B5 (stating that many institutional investors have holdings so large as to become permanent, long-term shareholders, and, as a result they have an economic interest in using corporate governance to improve performance). In doing this, institutional investors have rediscovered ownership rights, and improve the system of corporate governance. *Id.; see also Assets Surge, supra* note 6 (explaining that public pension funds are having a profound effect on corporate governance since they are generally the most activist of institutional investors).

[10] Kayla J. Gillan, *CalPERS – Corporate Governance,* VITAL SPEECHES OF THE DAY, May 15, 1995, at 475-78 (explaining that increasing value is a predominant factor for institutional investors, and, since they cannot simply sell stock, they must utilize and improve corporate governance to accomplish this goal).

every New York City, California Public Employee's Retirement System ("CalPERS"), or International Brotherhood of Teamsters ("Teamsters"), there are dozens more who are content to follow. But they are following, and this is enough to create critical mass, and it is enough to get people's attention.[11]

III. INSTITUTIONAL INVESTOR'S EFFECT ON UNDERPERFORMING COMPANIES

Jon [Lukomnik] mentioned that institutional investors are targeting poor performers.[12] Well, it did not start out that way. In fact, if you go back more than a decade ago and you look at the public pension funds that were the activists to start with in the corporate governance area, they were somewhat indiscriminate. They often chose good performers to raise questions about corporate governance.

I will never forget some of my friends at CalPERS coming back from a McDonald's meeting a number of years ago where they had introduced a resolution, I believe, that was on confidential voting or something like that. They said, "People booed us. They thought what we were doing was ridiculous because the company was doing great." That was a lesson well learned.

So targeting underperforming companies really became and important part of institutional activism.[13] It is much harder for companies to tell the owners "go away and do not bother us" when performance is bad. In fact, they do not even try anymore.[14]

---

[11] Hobson Brown, Jr., *What Do Institutional Investors Really Want?*, CORP. BOARD, May, 1996, at 5 (explaining how widespread shareholder activism has become).

[12] *See, e.g., CalPERS Names Poor Performers*, FIN. TIMES, Mar. 29, 1997, at 36 (stating that California Public Employee's Retirement System ("CalPERS"), the largest U.S. public pension fund, will target 10 poor performing companies in its corporate governance activism for 1997 proxy season); *see also* Marshall Meyer, *The Secrets That Lay Behind Improved Corporate Performance*, FIN. TIMES, Feb. 9, 1996, at 8 (explaining that shares of companies singled out as poor performers by the Council of Institutional Investors from 1991 through 1993 have since outperformed market by about fifty percent).

[13] *Supporting Material for Chapter IV; U.S. Corporate Governance*, OECD ECON. SURVEYS – UNITED STATES, Nov. 1996, at 196 (explaining that shareholder and especially institutional activism have been corporate governance's latest response to need for more monitoring and to SEC rule changes). A number of institutions have begun to target the government's practices of underperforming corporations in order to boost overall corporate performance. *Id.*

[14] Hyten, *supra* note 1, at 12 (explaining that directors have little choice but to listen to institutional investor's complaints).

Many of the changes that have occurred at companies in the last decade or so have occurred as a result of this type of institutional activism.[15] At General Motors Corp. ("GM"), International Business Machines Corp. ("IBM"), American Express Company ("AMEX"), Eastman Kodak, Inc. (Kodak"), Sears Roebuck & Company ("Sears"), Westinghouse Electric Corporation ("Westinghouse"), Kmart Corporation ("Kmart"), W.R. Grace & Company ("W.R. Grace"), and, as we speak, WMX Technologies, Inc. ("WMX"), institutional investors are using their power and their influence to bring about change at underperforming companies.[16]

CEOs of public companies now understand that their number one job is to create value for shareholders.[17] They certainly have other responsibilities, including responsibilities to non-shareholder groups.[18] We are hearing a lot more about those responsibilities today than perhaps we did even a year or two ago, but living up to the responsibilities to shareholders comes first by a long shot.[19]

IV. Institutional Investors and Corporate Governance

The second thing that institutional investors have done is to help to improve the system of corporate governance.[20] Let me just quickly go through some of the changes we have seen.

As I have mentioned, shareholder proposals by institutional investors have been used to raise corpo-

---

[15] Gillan, *supra* note 10, at 476 (explaining that institutional activism has caused, during 1992-93, more than 15 CEOs of Fortune 500 companies to be replaced by their respective boards). The corporations included some of the most famous names in the business world such as IBM, Westinghouse, AMEX, Compaq Computer Corporation ("Compaq"), Digital, GM, and Eastman Kodak, Inc. ("Kodak"). *Id.*

[16] *Id.*; *see also* Lorch, *supra* note 4, at 1 (noting that the CEOs at GM, Digital, AMEX, Westinghouse and IBM were all replaced).

[17] *See* Alexander, *supra* note 3, at E1 (explaining that director's primary duty is to increase shareholder value); *see also* Friedman, *supra* note 3, at 125 (noting corporation's duty is to maximize profits).

[18] *See* Faith Stevelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 587-89 (1997) (describing the recent increase in corporate donations); *see also* Robert A. Prentice and John H. Langmore, *Shareholder Alternatives to Hostile Takeovers: Restructuring, Auctions, and MacMillan II*, 20 STETSON HALL L. REV 4, 65-70 (1989) (examining non-shareholder interests and other stakeholder concepts).

[19] *See* Alexander, *supra* note 3, at E1 (explaining that corporate director's highest obligation is to maximize shareholder value); *see also* Friedman, *supra* note 3, at 125. (stating a corporation's primary duty is to make money for the shareholders).

[20] *See* Koppes, *supra* note 9, at B5 (explaining how institutional activism has improved the system of corporate governance).

rate governance issues since the mid-1980s. These efforts were largely symbolic, but they were a beginning.[21]

Next, institutional investors played a critical role in getting the Securities and Exchange Commission ("SEC") to change its proxy rules.[22] These changes, adopted in the early 1990s, had a very profound impact in opening up communication among shareholders of all sizes. But it particularly effected large institutional investors by allowing them to communicate among themselves on questions of corporate governance without fear of being sued.[23]

It was not until 1994, at the quiet urging of a number of institutional investors, that the Labor Department said that voting proxies is a fiduciary duty for institutions subject to Employee Retirement Income Security Act ("ERISA").[24] No one should underestimate the impact that the Labor Department regulations have had on institutional voting behavior, or the impact that voting patterns have had on corporate governance practices.

More recently, institutional investors have focused their attention on boards of directors.[25] Now, this seems like a no-brainer, but it is easy to forget how little was expected of boards as recently as a decade ago.[26] Often hand-picked by CEOs and loyal to the CEO, boards were widely seen as symbolic legal

---

[21] Nina Easton, *Interest in Takeover Reform Picks Up*, LEGAL TIMES, Nov. 19, 1985, at 1 (explaining that Congress will be listening to institutional investors about proposals that go to heart of corporate governance).

[22] Vineeta Anand, *Investors Want SEC to Re-examine Ruling*, PENSIONS AND INVESTMENTS, Aug. 21, 1995, at 26 (discussing the role that some institutional investors played in petitioning the SEC to change proxy rules); Victor F. Morris, *Institutional Investors and Corporate Governance*, FIN. ANALYSTS J., May/June 1997, at 91 (noting that giants, such as, CalPERS, Teachers Insurance and Annuity Association - College Retirement Equity Fund ("TIAA-CREF"), and other members of the Council of Institutional Investors are aware of their power and are making serious effort to transform proxy system from meaningless ritual to mechanism for projecting stockholders' interests that it was originally meant to be).

[23] Vineeta Anand, *supra* note 22, at 26 (noting that in the early 1990s, CalPERS and United Shareholders of America successfully petitioned SEC to change rules letting large shareholders discuss proxy voting strategies among themselves without formally notifying SEC first).

[24] James E. Heard and Jill Lyons, *Labor Unions and Public Funds Set Active Shareholder Agenda for 1995*, INSIGHTS, Dec. 1994, at 3 ("The U.S. Department of Labor's July 1994 interpretive bulletin sent a sharp reminder to fiduciaries by encouraging active ownership. The release reiterates the department's position that proxy votes are plan assets subject to ERISA's fiduciary standards.").

[25] Vineeta Anand, *Executive Update; Corporate Governance*, INVESTOR'S BUS. DAILY, Jan. 25, 1993 (stating that pension funds and other institutional investors have come to demand that directors do what in theory they were always supposed to do: hold management accountable for company performance).

[26] *See* Hyten, *supra* note 1, at 15. (according to this article, corporate boards have evolved from "a loose affiliation of yes-men to a demanding group of specialists who are aware of their duties. . . .").

structures, and little was expected of directors.[27]

It is still possible to find bad boards, but a lot has changed, at least insofar as expectations are concerned.[28] Boards of major public companies are expected to be independent and to act independently.[29] Directors are thought of as real people, with real jobs to do.[30]

The CEO has a voice in choosing directors, but not always the dominant voice.[31] Boards themselves are setting standards for their own conduct and for the conduct of the CEO, and they are evaluating performance, both their own and the CEO's.[32] Boards are setting ownership requirements, getting rid of questionable retirement programs and consulting arrangements for board members, and putting limits on the number of boards on which a director can serve.[33]

We are now seeing an emphasis on the qualifications of individual directors and on the performance of individual directors.[34] Both CalPERS and the Teamsters, for example, are focusing a great deal of attention on the qualifications and performance of individual directors.[35]

Executive pay is another issue on which institutional investors have had a significant impact.[36] Now

---

[27] *Id.*

[28] *See id.* (explaining that shareholders are more closely scrutinizing board activity).

[29] *See* Adam Bryant, *Investing It: The Search for the Perfect Corporate Board*, N.Y. TIMES, Aug. 3, 1997, at C1 (explaining that the wide range of basic CalPERS tests includes having majority of independent directors, a separate chief executive, independent chairman and independent committees for ethics, compensation, auditing, governance and board nominations).

[30] *See* Hyten, *supra* note 1, at 12 (stating that key functions of a board of directors have become more demanding).

[31] Sundaramurthy, *supra* note 8, at 783 (explaining how boards are influenced by CEOs).

[32] Gene Ramos, *Group Proposes Far-reaching Changes for U.S. Boardrooms*, REUTER BUS. REP., Nov. 12, 1996 (stating that boards are evaluating themselves and CEOs more often).

[33] Mary Kane, *Some Always Have a Meeting to Attend*, THE PLAIN DEALER, Nov. 3, 1996, at 3H (noting that some boards are limiting the number of other boards CEOs can sit on).

[34] Robert Lear, *Professionalism in the Boardroom; Board of Directors*, CHIEF EXECUTIVE, Mar. 1997, at 12. "The National Association of Corporate Directors, through a Blue Ribbon Commission headed up by the redoubtable Ira Millstein, has turned out a report on Director Professionalism. Developed by a group of 30 highly qualified and experienced people, the report calls for much tougher standards for selecting directors and operating boards." *Id.*

[35] *See CalPERS delays governance standards; Committee analysis of controversial points put adoption on hold*, DALLAS MORNING NEWS, June 17, 1997, at 18D. "CalPERS also will demand that boards adopt self-governance policies, including having written performance criteria for individual directors, such as attendance, preparedness and participation, and that the board have performance criteria and compensation incentives for the CEO." *Id.*

[36] *See* James D. Westphal, *CEO's Board Games*, J. COM., Aug. 28, 1997, at 9A (explaining that institutional investors have often caused executive pay to be linked to performance); Daniel Gross, *Pay for Performance? No Way: Long-Term Incentives Boom, Even When Stock Does Not*, CRAIN'S CHI. BUS., May 26, 1997, at 1. "CEOs and pay consultants say they're merely doing what their critics told them to do. And shareholder activists and institutional investors can claim victory in their long-running drive to tie compensation to company performance." *Id.*

it is true that executive pay is rising rapidly, and the disparity between pay at the top and average pay is greater than ever.[37] Many people think these are bad trends.[38]

But there have been two important changes that I would like to call to your attention, and I think the institutional investors are responsible in large measure for them. First, we have much better disclosure on pay than we had a decade ago.[39] We now understand all the elements of executive pay.[40] They are in the proxy, they are outlined for everybody to see, and the board has to explain what the board paid the CEO and why.[41]

We are also seeing pay linked to performance.[42] I will not go into too much detail here, but I think, as a general rule, it is fair to say that pay at the top is increasingly linked to performance, and I think that that is a good thing.

I labeled my talk "Institutional Investors: Agents of Change." While institutional investors are not responsible for all the changes that I have mentioned, it is hard to see how these changes would have occurred without their active involvement. Would we have proxy reform? Would proxy voting have become a fiduciary responsibility? Would we have developed the very broad consensus that we have developed about the role, structure, and the composition of the board? Would boards have come to believe that their primary responsibility is to help create wealth for the owners of the corporation? And would boards have acknowledged that they must not only be responsible, but accountable, for their performance?

What about the future? Is there a need to reshape our system of corporate governance? Has share-

---

[37] Mark Calvey, *Exec Pay Rides Soaring Sales, Bull Market to New Heights*, SAN FRAN. BUS. TIMES, June 7, 1997, at B3 (explaining that executive salary is increasing more than ever, top 100 executive salaries in 1994 start at $ 940,000. In 1995, $1.93 million, and in 1996, $2.27 million -- a two-year increase of 142 percent).

[38] *See* Westphal, *supra* note 36, at 9A (explaining that linking pay to performance has caused huge CEO salaries due solely to the bullish stock market, and had very little to do with actual corporate performance); Gross, *supra* note 36, at 1 (stating how linking pay to performance simply pays CEOs more during a bull market and does not affect the true performance of a company).

[39] Brent M. Longnecker, *Smart Compensation Programs for Today's Regulatory Environment*, COMPENSATION AND BENEFITS REV., Sept. 1995, at 47 (discussing administrative hassle in complying with all of new federal pay disclosure requirements, and in particular, latest SEC executive compensation requirements for proxy reports files by all SEC-registered companies).

[40] *Id.*

[41] *Id.*

[42] *See* Westphal, *supra* note 36, at 9A (discussing linking CEO salary to performace); *see also* Gross, *supra* note 36, at 1 (discussing issues of CEO pay).

holder activism gotten out of hand? Again, a little bit of history might be helpful.

A decade ago we were looking at other models, such as the German model[43] and the Japanese model[44] - not only the economic models, but also governance models - and saying, "Maybe there is a better model then ours."[45] This was at the time, of course, when our own industries were going through a bad period and we felt that we were not competitive in world markets.[46]

Today, American businesses are more competitive globally than they have been in decades.[47] In contrast, German and Japanese companies have been slower to adapt to new global realities.[48] Perhaps their shareholders have been a bit too patient. Perhaps our system, even with many shareholders focused on next quarter's performance and the next day's stock price, is better than we thought. And perhaps the disharmony that has frequently characterized relationships between corporations and their larger shareholders has served us better than we thought a decade ago.

My view is that our current corporate governance system is sound.[49] It can be made to work better, but there is nothing fundamentally wrong with it.

Probably the single most important change that we can make is to continue to work to improve the independence and the accountability of boards of directors.[50] Despite the changes of the last decade that I referred to, many boards are still very slow to act when corporate performance heads south.[51] Time after

---

[43] Martin Dickson, *Cultural Differences Break Down in the Boardroom – Growing Pressure for Change in the Way Companies Are Run*, FIN. TIMES, October 16, 1992, at 19 (explaining that Oxford study shows that German Model is only one of seven countries where system of corporate governance does indeed result in effective oversight of management by representatives of other stakeholders.)

[44] *Id.* (explaining differences between Japanese model and U.S. model).

[45] *Id.* (comparing foreign model of corporate governance to U.S. model).

[46] *Wanted: A Stronger Policy to Stimulate U.S. Exports*, BUS. W., July 16, 1979, at 88 (stating that while U.S. has neglected international markets, economically successful nations such as Germany and Japan have been powering their industrial surges with relentless drives to sell more of their products abroad). By capturing ever-larger slices of export markets, which have been expanding faster than domestic ones, they have succeeded in linking their growth to the most dynamic sectors of the global economy. U.S. industry, by contrast, is losing shares to foreign producers even in the U.S. home market. *Id.*

[47] Greg Mastel, *Germany Seeks U.S. Solutions*, J. COMM., Apr. 1, 1996, at 6A (stating that the United States has regained leadership in number of sectors and is world's largest exporter).

[48] *Id.* at 6A (stating that Germany can learn from U.S. style of corporate governance).

[49] *Id.* (explaining that the U.S. and German systems of corporate governance are both viable).

[50] *See CALPers Delays Governance Standards, supra* note 35, at 18D (stating that one of the main goals of the CalPERS first formal corporate governance standards is to make board members independent).

[51] *See, e.g.*, Beth Freedman, *List Narrows in Search for IBM CEO*, PC WEEK, Mar. 22, 1993, at 3 (explaining that the board at IBM was having difficult time not only finding a CEO replacement for John Akers, but deciding on turnaround strategy for IBM).

time, boards have waited too long to change strategy, or structure, or leadership.[52] The result is often the destruction of billions of dollars in shareholder wealth and the loss of thousands of jobs. When those responsible finally leave, they exit with severance packages worth many millions. And the directors who have allowed all of this to happen are applauded for holding management accountable.[53]

V. CONCLUSION

If we have learned anything in the past decade, I think it is that setting higher expectations for boards and insisting that they be accountable for their performance can make a difference.[54] Institutional investors can and should continue to play an important part in improving board performance. Here are some things that they can and should do:

- They should confront individual companies over poor performance, as they have been doing.[55]
- They should work to reform board compensation and to require better disclosure of board pay, a topic that I did not have much time to go into tonight, but one that I think deserves a lot of attention.[56]
- Institutions should set their own standards for board conduct and communicate those standards to portfolio companies.
- They should urge portfolio companies to develop, disclose, and implement their own governance standards.[57]
- They should be willing to single out individual boards and individual directors either for praise or criticism.[58]

---

[52] *Id.*

[53] *See, e.g.*, Jeff Bailey, *WMX'S CEO Got Severance of $12.5 Million*, WALL ST. J., Mar. 17, 1997, at B10 (explaining an occurrence where a CEO received $12.5 million severance for resigning).

[54] *See* Hyten, *supra* note 1, at 12 (explaining that boards are now more accountable for performance); Anand, *supra* note 22 (explaining that institutional investors are holding directors more accountable).

[55] *See CalPERS Names Poor Performers*, *supra* note 10, at 36 (explaining that CalPERS targets poor performing companies).

[56] Jessica Davis, *Investors Now Scrutinize How Directors Are Paid*, PHILADELPHIA BUS. J., July 28, 1995, at 10 (discussing reforming director compensation).

[57] *CalPERS Delays Governance Standards*, *supra* note 35, at 18D (stating that CalPERS is setting their own standards for board conduct).

[58] Jay Lorsch, *Should Directors Grade Themselves?*, ACROSS THE BOARD, May 1997, at 4 (discussing evaluation of individual directors).

I also think that the institutional investors need to reconsider the question of whether they should play a more active role in selecting directors. Here also a number of approaches are possible:

● Institutions can, and some do, meet with the board nominating committees to discuss qualifications and standards for directors.[59]

● Institutions can and should provide suggestions for nominees.

● Institutions could, if they wished, and this is something that has been discussed for several years now, establish a clearinghouse to screen potential nominees supported by institutional investors.

● Institutional investors can vote no, as they have on some occasions, against unacceptable nominees.[60]

● Where necessary, institutions should be willing to nominate and solicit support for their own candidates in opposition to management slates.

Most of what I have suggested that institutional investors should keep working on does not require legal or regulatory reform. We have seen, over the last decade, that this can be done if institutional investors, acting as fiduciaries, decide that it is worth their while to use corporate governance as one of the ways to increase shareholder value.

Thank you.

---

[59] Ingrid Becker, *Corporate Power in Marin*, INDEPENDENT J., Oct. 29, 1995, at A1 (describing situation where institutional investors are demanding greater scrutiny of prerequisites and qualifications of directors); *see also* Lear, *supra* note 34, at 12 (discussing a report on director professionalism that calls for tougher standards in selecting directors); Hyten, *supra* note 1 (stating that boards are picking and choosing some members for their specific knowledge in a given area, and that there is a trend for more specialized board members).

[60] Vineeta Anand, *Finds Flexing Muscle Early in Proxy Battles*, PENSIONS AND INVESTMENTS, Mar. 17, 1997, at 20 (describing a situation where about a dozen public and labor union pension funds, all members of the influential Council of Institutional Investors, exercised vote of no confidence in Disney's directors). Many of them also voted against an executive bonus package and Michael Eisner's new Contract. *Id.*